

BUSINESS RESOURCE CENTRE

Small Business Finance Plan



SMALL BUSINESS FINANCE PLAN

SMALL BUSINESS MANAGEMENT SYSTEMS

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PREFACE

The greatest cause of business failure is said to be in the management of the business, and this includes financial management. Yet, even in adverse economic circumstances, a well thought-out and well managed business enterprise need not run into financial problems. There are a number of sources of both internal and external financial assistance open to the entrepreneur, but he/she must know about them and how to approach and use them. That is the primary aim of this publication: to identify sources of finance for small business and to help individual businesses to tap those resources.

Another objective is to familiarize you or refamiliarize you with the essentials of business planning and the powerful backup of financial statements, well-prepared, by which new funds can be pumped into your business. An application to your bank, for example, can be drawn in broad strokes or filled in with persuasive detail; but, despite the amount of supporting detail that may be required, your presentation must meet one overriding provision: it must show how the funds you want will help your business and provide the repayment of the loan in a reasonable time.

The next objective is to highlight ways in which you, as a business owner, can make your own money, derived from your own business, go further. Consequently, this guide briefly assesses what you can do to ease yourself over financial hurdles by using the business practices common to business enterprise in order to reduce your dependence on outside capital sources (after all, these cost money). To help you make the most of your own business potential, the handbook deals with "Internal Financial Management", as well as outlining "External Sources of Financing".

This publication is one of a series that has been prepared by Manitoba Industry, Trade and Tourism to assist the independent entrepreneur in Manitoba. It is not an all encompassing guide to the operation of a small business, as it focuses largely on financial management. The entrepreneur who requires guidance on other aspects of managing his business should consult some of the other volumes in the series: "Marketing", "Service Business Plan", "Retail Business Plan", "Manufacturing Business Plan", "Construction Business Plan", "Manitoba Franchise Guide". A new series of "Self Evaluation Guides" has been developed for 3 stages:

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PLANNING YOUR FINANCIAL REQUIREMENTS

PREPARING TO BORROW

Although the large corporation is perhaps the most visible form of enterprise in the Canadian economy, accounting for the highest number of employees and the lion's share of the gross value of production, the most common establishment is that of small business. Whether it is in manufacturing, in the service trades, including merchandising — that is, whether it produces goods, retails the goods of others, or offers services — small business is a preferred way of life for tens of thousands of Canadians. In Manitoba, 75% of the businesses employ fewer than 50 people.

Yet success in this field calls for special qualities of perseverance, business know-how, and a high degree of initiative. Business is never static; it is subject to many influences, over some of which it has little or no control. In the very small business, the owner-manager can call upon few experts in his own company: in many respects, he/she is the company and must learn to meet, dodge or roll with the punches.

Today, however, because of the importance of small business in a market economy, help is widespread: from government departments, boards of trade and chambers of commerce, trade associations, local development corporations, professional accountants, financiers, lawyers, business consultants, and many others. There are times when advice should be sought and, if necessary, bought.

It is the rare business enterprise that has sufficient capital of its own to set up and operate without recourse to bank lending or other sources of external finance. Unlike large, well known corporations, a small enterprise is unlikely to be able to offer company bonds or stock to the public and, unless it is a most unusual type of enterprise, cannot attract private venture capital, which looks for quick growth and fast returns.

Even your neighbourhood banker, finance company, or credit union will want clear assurance that your business organization or proposed business organization is sound enough to meet competition at a profit. That profit must be sufficient, over a reasonable period of time, to repay money advanced to your business.

Government sponsored and other lending institutions will want to know the grounds on which you base your optimism and the kind of forethought and market research you have already put into your project.

They will, therefore, all want to review your past financial history or financial projections to see that you will remain solvent and be able to repay their cash advances. These may be backed by a mortgage on property, or a line of credit against accounts receivable, to mention just two forms that their financial assistance might take. Their concern is natural, for the management of these institutions is responsible to someone else for their stewardship — to shareholders, bondholders, or the tax paying public.

The first step in preparing to borrow is to draw up a business plan. This fulfills three functions: it helps to clarify your business goals and the resources you have to achieve them, it helps keep your business position clear and it is an important document to offer when you do seek outside capital.

THE BUSINESS PLAN

Whether he/she knows you or not, the prospective lender will want facts about you and your business down on paper. These will include your financial proposals, whether you are seeking money to start a business, to expand or improve the business you now have, or need extra money to smooth out the humps when working capital is short at certain times in your business cycle.

Business plans are much more than a digest of your background and experience, and your current operation or projected business venture: they are analytical tools which can point out danger signals or, conversely, opportunities in a business operation. They help keep your goals defined and relevant to your market (if you are in TV sales and service, you might find that you are doing more repair than selling, and you should rightly be in the TV repair service business).

Excess raw materials or finished inventory will show up on a business plan (and working capital shouldn't be tied up in storage bins). Perhaps sales are slower than customary for the season, or the production of finished goods has taken a slump, while raw materials have stockpiled. On the other hand, perhaps sales are rising, but actually inventory shortages are slowing manufacturing and delivery and you are losing customers.

Machine replacement may be imperative and may push you into capital replacement. Can you afford it out of revenues and, if not, what is the best means of financing its purchase? Perhaps leasing is the answer.

The business plan, in short, can provide a platform from which to make or propose changes in your operations and, at the same time, it provides a succinct description for a prospective lender which will help him/her make a sounder judgment of your financial needs. Since lenders to small business are usually people of experience in the problems faced by such business, they can show ways to improve on your plan, at a saving to yourself. Remember, any reputable lender is conscious of the need for safety in his lending even though he/she is naturally anxious to make a deal.

The Business Plan Outline

The following business plan outline has been provided as a guide to the person wishing to engage in a small enterprise. It can also be used by anyone engaged in an existing enterprise, who might be considering a business expansion, or the buying out of a competing or related business.

It can apply, with modifications, to individuals involved in retail sales or service occupations as well as those in small manufacturing operations.

It serves, as noted earlier, a three-fold purpose:

1. it should help clarify business objectives;
2. it will give an indication of potential strengths or weaknesses in the operation of the business; and
3. at the same time it will provide an analysis by which a potential lender can make a decision, providing the plan is accompanied by the relevant financial statements.

Using the headings provided, the business plan should be prepared, incorporating as much detail as is needed, to make your operation clear to a prospective lender.

A. Prepare a brief summary

- (1) A description of the business;
- (2) The amount of money required and what you are going to do with it;
- (3) What security you will pledge; and
- (4) Summary of earnings projections.

B. Background information

- (1) Past history of the company (should be brief and concise);
- (2) Provide the legal status of the company (indicate whether the business is a sole proprietorship, partnership or corporation). Include dates of commencement or incorporation, and a list of the names and addresses of the owners and what percentage of the business they own. You may wish to include a statement of personal net worth (see Worksheet 1, page 27).

C. Products and Services

- (1) Provide a description of your products and services with an assessment of their strengths and weaknesses;
- (2) Patents, trade secrets and other technical advantages;
- (3) Technologies used; and
- (4) Discussion of the industry and industry projections.

D. Management

- (1) Organization of the company;
- (2) Provide brief management biographies of key personnel (include their ages and backgrounds in this type of business); and
- (3) Management compensation.

E. Marketing

- (1) Identify:
 - the total market
 - target market
 - your competition (give estimates of the size of the market each competitor holds, give specific names)
 - your marketing advantages relative to competitors
 - your past sales and future projections
 - risks
 - your pricing policy
 - your selling terms (credit policy)
 - distribution plan
- (2) Marketing strategy:
 - promotion plans
 - methods of selling

F. Land, Buildings and Equipment

- (1) Location:
 - give description
 - provide reason for locating where you have
- (2) Provide details as to the amount of land required, site plan, costs of land and buildings, including installation of services.
- (3) List all machinery and equipment required:
 - indicate costs and installation charges; and
 - indicate from whom and where purchases are to be made.

G. Operations

- (1) Work flow:
 - provide diagrams if applicable; and
 - quality control procedures to be used.
- (2) Inventory control
- (3) Supplies and Materials:
 - availability of supplies, costs and terms
- (4) Manpower Plan:
 - include informal job descriptions along with organization chart,
 - give salary or wage schedules.
- (5) Manufacturing cost estimates
- (6) Operations Schedule:
 - time schedule
 - key events and decision points

H. References

- (1) Name of bank or others with whom you have had financial dealings:
 - give types of loans, terms, etc. previously held
- (2) Name of accountant, lawyer or other professionals with whom you have had business relationships.

I. Financial Plan

- (1) List all capital requirements and sources of financing;
- (2) Provide profit and loss statements and balance sheets for the present and the preceding three years; and
- (3) Provide projections, cash flow budgets, pro forma income statements, pro forma balance sheet, and a break-even chart (if appropriate).

J. Summary of Critical Risks and Assumptions

Supplementary exhibits can also be attached to the application including personnel resumes, community benefits, other supporting documents.

Be thorough in your written presentation. The more details supplied to support the application, the more likely it is that you will earn the lender's favor.

INTERNAL FINANCIAL MANAGEMENT

BASIC FINANCIAL STATEMENTS

There are some half-dozen financial statements involved in a company's business finance. Many of you will be familiar with balance sheets, profit and loss statements, cash flow statements, capital budgeting, expenditures forecasts, and sales forecasts. If you've been in business you have the records of past performance to guide you; if you are starting a business, you may have to become familiar with them. Some businesses are so vast that whole departments are devoted to financial (and accounting) functions and, in turn, they call on sales, production, advertising, and other departments to supply data when the company is carrying on financial planning or perhaps preparing an annual report to shareholders.

A description of basic accounting records and financial statements is provided in Appendix A.

CASH FLOWS

The most important tool for small business management planning is a cash flow or cash budget. A cash flow is simply an estimate of when you expect to receive cash from your sales and when you expect to pay your bills.

A written cash flow allows business managers to identify priorities for accounts payable and to schedule anticipated cash receipts. More importantly, it provides an estimate to the amount of money required to finance day-to-day operations. It also shows the lender that the business will have sufficient cash to carry loan payments on a term basis.

Planning by use of a cash flow is a continuing activity and should be reviewed periodically to ensure accuracy. By continually reworking the cash flow, it will become indispensable to the management decision-making process.

HOW TO PREPARE A CASH FLOW

The first step in preparing a cash flow is to estimate sales on a monthly basis. Sales from previous years can be used to forecast sales for the coming year. There are many yardsticks by which a business can estimate its sales. A relatively conservative or low forecast can be used to determine the financial results of bad times. An optimistic forecast will show the strain on working capital which may result from better than expected operations. Finally the most probable sales forecast at the centre remains the anchor point upon which plans are made.

Decide what amount of your sales will be cash and what amount will be credit. If last year's sales were 10% cash and 90% credit and you do not plan to change your credit policies, chances are that the same proportions will occur again this year. If you sell on credit, take into account when you can expect to collect the accounts receivable.

You have to know how quickly you can expect to collect amounts owed by customers. You can also expect that some portion will never be collected.

	Jan	Feb	Mar	Apr	May
Projected Sales	\$10,000	\$10,000	\$10,000	\$10,000	\$10,000
Cash Sales	1,000	1,000	1,000	1,000	1,000
Collection of last month's sales	—	5,000	5,000	5,000	5,000
Collection of sales from two months ago	—		3,000	3,000	3,000
Collection of sales from more than two months ago	—			1,000	1,000
TOTAL CASH COLLECTION	\$1,000	6,000	9,000	10,000	10,000

In this example, January's total sales of \$10,000 are actually converted into cash over 4 months. Similar patterns will be experienced for the other five periods.

The next step is to plan for accounts payable on a monthly basis according to your sales projections. For example, if you pay your invoices on a 30-day basis, then the cash expenditures for January's purchases will be made in February. If you obtain trade credit for longer terms, then cash outlays can be further delayed.

Now that total cash collections and total cash payments have been estimated, make another work sheet (as shown on the next page) listing all cash transactions for the month. Remember — only list the actual cash you are expecting to receive or spend in the appropriate monthly column. An explanation of each entry is made following the form.

	Jan	Feb	Mar	Apr	May
Planned Purchases					
Payments on this month's purchases					
Payments on last month's purchases					
Payments on purchases from two months ago					
Payments on purchases from more than two months ago					
TOTAL CASH PAYMENTS					

NOTE: Cash flows should be made up for an entire 12-month period.

INCOME (CASH ONLY)	MONTH 1		MONTH 2	
	PLANNED	ACTUAL	PLANNED	ACTUAL
1. Cash Sales				
2. Collection from Accounts Receivable				
3. Loan Proceeds				
4. Sale of Fixed Assets				
5. Other Cash Received				
6. TOTAL CASH IN				
EXPENSES (CASH ONLY)				
7. Rent (for premises, equipment, etc.)				
8. Management Salaries				
9. Other Salaries and Wages				
10. Legal and Audit Fees				
11. Utilities (heat, light and water)				
12. Telephone				
13. Repairs and Maintenance				
14. Licences and Municipal Taxes				
15. Insurance				
16. Other Operating Expenses				
17. Payments on Purchase of Fixed Assets				
18. Interest Paid on Loans (short-term loans, lines of credit, overdrafts)				
19. Payments on Mortgages/Term Loans				
20. Income Tax Payments				
21. Cash Dividends Paid				
22. Payments on Accounts Payable				
23. Other Cash Expenses				
24. TOTAL CASH OUT				
25. SURPLUS OR DEFICIT (Subtract cash in minus cash out)				
26. OPENING CASH BALANCE				
27. CLOSING CASH BALANCE				
28. TOTAL SALES				
29. MONTH END RECEIVABLES TOTAL				

Explanation

- lines 1, 2 & 22: These lines of the cash flow have been completed by the exercise on pages 6 and 7 and their total should now be inserted on the worksheet.
- line 3: Loans — If you take possession of borrowed money during the month, list this cash receipt.
- line 4: Sale of fixed assets — if you sell a fixed asset such as a piece of office furniture or a vehicle, list this cash income in the monthly column when payment is received.
- line 5: Other cash — give all other cash income such as interest, rent, etc.
- line 6: Total of lines 1 - 5.
- lines 7 - 16: Operating expenses — enter the amount of cheques that you write for your monthly expenses. This is actual cash outlay for the month. For example, if you write a cheque in January for the full year's insurance then the amount of the cheque would be put in the January column and nothing would be entered for the rest of the year.
- line 17: Payments on purchase of a fixed asset — if money is spent for the purchase of fixed assets such as a vehicle or a filing cabinet, list the amount for the month when the cheque is written.
- line 18: Interest paid on loans — this is the interest paid monthly on short-term loans such as bank overdrafts or lines of credit. Since you are in the process of working out the amount of money you will need to borrow, this interest figure may be very difficult to estimate. Consequently, you may decide to leave the line blank for now. If it is likely to be a small amount, you may decide to omit it altogether.
- line 19: Payments on mortgages/loans — indicate the monthly payment for the principal and interest on long-term loans. For example, if you borrow \$3,000 to purchase a ½ ton truck and monthly payments are \$100 with the first payment due in March — then \$100 will be entered in line 19 for each month beginning in March.
- lines 20 - 21: Income tax payments and cash dividends paid — the amounts you expect to pay, if any.
- lines 16 & 23: Other operating expenses and other cash expenses — the expense items listed in this format may not be applicable to your business. The headings should be changed so that they are appropriate for your situation.

- line 24: Total all possible cash payments for the month.
- line 25: Surplus (or deficit) — cash in minus cash out.
- line 26: Opening cash balance is the amount of money with which you started the month.
- line 27: Closing cash balance is the amount of money you started out with plus (or minus) the amount of cash made (or lost) in the month. The closing cash balance becomes next month's opening cash balance.
- If adding lines 25 and 26 produces a negative amount, then that is the amount that will have to be borrowed in order to make planned payments.
- line 28: Total sales — this is the amount of sales volume for the month including cash and credit sales.
- line 29: Month end receivables total — this is the amount of money owing from this month and previous months' sales. Total sales and receivable totals are not an inherent part of the cash flow although it is important to keep track of these figures for future planning.

Because this cash flow projection is to be used as an aid for planning future business needs, it is sometimes best to put it away for a few days and then study it again to see if it still makes sense when compared to last year's operation.

It is important that the cash flow is completed on an ongoing basis and is revised as the situation changes. After each month has been completed, put the actual cash flow figures next to the planned figures and compare them. If the planned figures vary considerably with the actual, it may be necessary to rethink the position of the business.

A cash flow assists in financial planning, inventory purchases and formulating credit policies. It also serves as an early indicator when expenses are getting out of line. It is one of the most important tools an owner-manager has to control his/her business.

INTERNAL SOURCES OF FUNDS

Many business owners seeking financing from outside sources could possibly be in a position to use their own resources, providing inventory purchases, accounts receivable and accounts payable are handled correctly. This could "free up" funds otherwise unavailable. It also makes your business more efficient and puts you in a better position to obtain outside financing, should this be necessary.

Receivables

One obvious source is accounts receivable. A business needs sufficient capital to meet its current commitments but if money is tied up in receivables, the business can be irreparably harmed. Unless receivables can be converted into cash in a minimum period of time, the business firm will lose its liquidity, exhaust its credit and find its growth potential limited. Receivables can be reduced by better credit policies, better policing of credit or by more diligent collection policies.

The granting of credit can often lead to a precarious situation for a business. Many businesses have failed because of bad debts. There would be fewer bad debts and overdue accounts if more attention were paid to the initial granting of credit. Business managers should not overlook the difficulty of collection because of the prospect of a good sale.

A good accounting system is crucial to controlling accounts receivable. Accounts should be regularly aged and overdue payments immediately flagged for attention and action.

Some businesses post and balance customer accounts on a current basis, thereby allowing them to send out statements to customers early in the month. Other businesses rely on service bureaus for collection but one should be aware of the costs involved and the loss of goodwill. It is important to recognize that the quicker receivables are turned into cash, the more current money the firm has available with which to finance inventory and other assets.

Inventory

Improper inventory control is both a common and a major problem. Very often, small businesses do not maintain the proper level of stock: either too much is on the shelves, or there's not enough to satisfy customer demand. Either customers leave dissatisfied and go somewhere else, perhaps permanently; or you have stock which sits on the shelf for months. This represents money you cannot use in your day to day business. At today's interest rates, having large amounts of money tied up in inventory can represent a formidable expense.

You must schedule your inventory purchases in such a way that you have neither too much nor too little. To do this, you estimate when sales are likely to be made and ensure that you have a basic level of inventory at all times. This may result in some excess, but with experience, you can gradually refine your guidelines.

Some businesses may need to purchase inventory more than a month in advance. You can follow the same idea but adjust to suit the peaks and valleys in your expected annual business flow. In other words, develop long range schedules for your purchases. When you have established a minimum for any period, you purchase enough new units or manufacture them so that units on hand plus new units equals the monthly minimum in preparation for the succeeding month.

Payables

Often businesses can benefit from credit granted by suppliers. Under competitive pressure, suppliers may be prepared to provide financing through special or extended terms of payment. However, a business can become too firmly attached to a particular supplier because of significant credit assistance. This could lead to the situation where the business will have to continue to purchase from the supplier, even if the supplier ceases to be competitive in terms of price, quality, delivery, and service. Good credit terms from suppliers can come about as a result of careful, tactful negotiation by the buyer.

Some businesses obtain credit by delaying the payment of their bills. Some of the most respected businesses in the world use this tactic but, sooner or later, a firm will run the risk of losing the goodwill of its suppliers. Habitually poor bill payers can expect their suppliers to impose stringent credit conditions to the extent of asking for prepayment of goods or services. As well, those who are slow to pay can expect slow delivery and poor service.

A new small business can expect suppliers to be very careful about granting trade credit. The best policy is a frank discussion with suppliers about the terms they are willing to extend and full disclosure of financial plans. A small business with good equity capital and managed by a person who shows an awareness of financial management can usually get fair accommodation from the beginning. As the business's creditability with suppliers grows, extended terms can be negotiated. However, a small business sooner or later should demonstrate its ability to pay early and promptly.

Prepayments and Employees

In some cases, a business can encourage its customers to make payments prior to production or delivery of the goods or services. For example, mail order businesses generally ask for payment prior to forwarding their goods to the customer. Custom manufacturers also often ask for prepayment of goods. These prepayments may form a fairly permanent source of working capital. Sometimes special pricing and special terms may be necessary to attract prepayment deposits.

Another source of internal financing which may be available to an existing business is its employees. Employees with access to capital may be willing to invest in the company because they understand its products and trust the management. If an employee has a stake in the company's future, it could positively influence his working habits and concern for the company's success. On the other hand, because the employee has a share in the business, it could prove difficult to remove, retire, or replace him if he becomes unproductive or uncooperative. The idea of employee investment should be approached with the utmost caution.

Stretching Your Business Dollar Further

Besides manipulating accounts payable and receivable, and planning basic inventory scheduling, there are a number of ways in which short-term benefits may be realized. Such considerations as those following often mean less stable long-term positions, but they have their place quite legitimately in business practice, especially for new and developing business. They include:

- rent factory or store space instead of building or buying;
- purchase second-hand machinery;
- substitute extra labour in place of labour-saving equipment;
- assemble rather than manufacture, i.e., sub-contract out if possible;
- purchase an existing business instead of setting up a totally new operation;
- handle only those product lines on which you get the most favourable credit terms;
- sell only to cash or quick-paying credit customers;
- develop more efficient production scheduling to get products available for quick sale, but at greater cost per unit; and
- operate as a subcontractor to a larger business.

Most of these methods of conserving capital or making the dollar stretch farther, though often used in small business, do have serious shortcomings. In effect, they postpone the day when new capital investment is required to replace worn-out machinery, or to undertake economies of scale that are derived from buying materials in bulk.

Some, such as leasing or renting premises, specializing in certain product lines, or acting as a subcontractor may be sensible business decisions over the long-term. One must realize that borrowing on secondhand assets or with no plant ownership to underpin a mortgage, may make it difficult to give stability to a business, and to obtain operating funds when needed — but a great number of successful enterprises have nonetheless developed along these lines.

EXTERNAL SOURCES OF FUNDS

The next few pages deal in brief form with external sources of finance. In getting to the right source for your particular needs, you will want to check out several of the sources listed. But, besides being equipped with your various financial statements, there are one or two points to bear in mind.

Just as you are in business to make money, so are commercial lenders. Lending organizations which are government-sponsored may be in business for slightly different reasons. As a matter of public policy, government lenders may be set up to help the firm which cannot get regular financing, or only on prohibitive terms. Moreover, the location and kind of business are important, as many companies are assisted who can be seen to bring significant economic benefit to an area.

Wherever you go for financial help, you must be prepared to learn their language and familiarize yourself with the common terms used in banking and financial practice. At the same time, you should be able to outline your requirements in terms that can be understood by the lender so he/she can translate your needs into the appropriate financial plan.

Two factors are all-important: you must be able to show that a reasonable portion of your own money is being risked in your own business, and you must demonstrate a feasible repayment plan. This shows confidence and is a guarantee that your full efforts will be devoted to its success. Finally, approach financial agencies after you have explored every avenue of your own business (actual or projected) for earnings and savings, and can demonstrate that fact.

EQUITY FINANCING

Equity is money that is put into the business other than from outside loans. The most obvious source of equity financing is the individual starting the business. The equity may come from personal savings, securities, relatives, or the sale of real estate, but it is put up by the individual or persons who will have ownership of the business.

Many people have the mistaken impression that financial institutions, or government agencies, will provide all or most of the basic capital required for a business venture. In fact, the entrepreneur himself must assume the bulk of the risk and does so by committing his funds to the business. The amount of equity investment required varies widely, depending upon the kind of business, experience of the owners, current economic prospects, etc.

In Manitoba there are a number of different forms of business organizations which can influence the way equity is put into a business.

The simplest type of business organization is a sole proprietorship. In a sole proprietorship, the owner supplies the money necessary to fund the business. He/she owns all the assets and is responsible for all the liabilities. If the owner cannot supply all the equity capital needed, he/she may have to find one or more partners willing to put money into the venture. Obtaining a partner means that the ownership will be shared as well as the liabilities. In a partnership, each partner can be held personally responsible for obligations placed on behalf of the business by other partners.

Sometimes the partner is "silent" which means he/she will help supply the capital while you supply the "know-how". There should be a word of caution here: you should be very careful in choosing a business partner. Many partnerships fail because the partners cannot get along. When entering into a partnership, a written agreement should be drawn up between the partners to protect their individual interests.

There is a special legal arrangement whereby a person may contribute financially but cannot be engaged in conducting the affairs of the partnership. This is called a "limited partnership".

A limited partner is normally only liable to the firm or its creditors to the extent of the capital he/she has agreed to contribute towards the partnership. To remain a limited partner, a person must take no part in the management of the firm, nor may he/she act on behalf of the company, or he/she becomes a general partner.

The taxation and liability position of a "partner" is complicated. If you are in a position where you have to form a partnership, you should perhaps go on to the next stage, incorporating.

This final form is called a limited company (corporation). In a corporation, ownership is shared, generally in proportion to the amount of money each person puts up.

In attempting to attract partners or other equity investors, newer and smaller businesses must be able to demonstrate profitability of the venture. Investors can obtain returns exceeding 10% with relatively safe investments in mortgages and bonds. Therefore, in order to invest in your enterprise, which probably carries a greater degree of risk than mortgages, the business must promise better financial returns. Investors must be convinced that the payoffs will be attractive

and the risks minimal. One method of doing this is with a well-documented business plan as given in the chapter on financial planning in this handbook.

Going Public

It is possible to obtain equity financing by offering shares in the business for sale to the general public. The procedure to do so is quite complicated and expensive, and is really not an alternative for the ordinary small entrepreneur. If more information on this method of financing is required, one should contact a lawyer or an established investment dealer.

Venture Capital

There are some firms which will supply money to a fledgling business in return for equity participation (part ownership). They are known as venture capital firms¹. It must be remembered that such firms are hardnosed and professional, and are interested only if they see an opportunity to make profits for themselves.

Contact Manitoba Industry, Trade & Tourism, Business Resource Centre, 945-7738 to enquire about financial assistance programs available.

DEBT FINANCING

Most firms borrow money to transact their affairs. There are a number of sources that will lend money to businesses in Manitoba including banks, credit unions and government (see Appendix B, Sources of Business Finance). Entrepreneurs should attempt to familiarize themselves with the lender's requirements and determine which type of borrowing is most suitable for their business.

One cardinal rule of finance should be observed: that is, long-term use of funds should be supplied from long-term sources of funds. In other words, avoid imbalance in financing. Long-term debt financing should not be used for short-term working capital and, conversely, working capital should not be used to finance long-term fixed assets.

Fixed Assets Financing

It is useful to think of business credit as being divided into two categories, one concerned with medium and long-term credit of more than one year, and the other with short-term credit of one year or less. The fixed assets of a business, i.e. those having a life of more than one year, are ordinarily financed from equity capital contributed by the owner or by medium or long-term loans having a duration related to the expected life of the assets.

One method of obtaining fixed asset financing is to negotiate a "term loan". A term loan is a business loan which has a maturity of not less than one year and usually does not go beyond 10 years.

The security offered for repayment is normally a form of chattel mortgage against the equipment or other property being financed. The length of the repayment schedule is generally related to the useful life of the asset. The lender will only give a percentage of the value of the asset being purchased. For example, a bank may lend up to 75% of the value of a truck to be repaid within five years, whereas the same bank may lend up to 80% for a building to be repaid within 10 years. The balance of the money owing for the assets would come from the equity contributed by the owner.

The advantage of a term loan is that the terms, including repayment schedules, can be negotiated between the lender and the borrower. The loan agreement is based upon the ability of the borrower to repay the loan out of earnings, generally in installments. As long as the borrower complies with the terms of the loan, he has assurance that no payments other than regular installments will be required prior to the due date of the loan. There is the added advantage that the lender and borrower develop a relationship over a relatively long period of time and that the lender can be of assistance in advising on financial matters and perhaps be able to offer additional financial assistance.

When lending on a medium or long-term basis, credit institutions tend to place emphasis on the earning power of the business over a period of years and on its ability to repay the debt. The business owner must, therefore, convince the lenders that the business is sound, preferably by the use of a business plan.

One of the more important indicators used by lenders to demonstrate the soundness of the business' financial position, is the debt-to-equity ratio. For example, if your business owes \$4,000 to others and you have only a \$2,000 investment in the business, then your debt-to-equity ratio is 2:1. Some lenders interpret this ratio differently, but for new businesses it is unlikely that the lender will go beyond 2:1.

Another key indicator is the current ratio, the ratio of current assets to current debt. This is used as a measure of short-term solvency. For example, if your cash on hand and accounts receivable add up to \$6,000 and your accounts payable are only \$2,000, then your current ratio is 3:1, which is favourable. This demonstrates to lenders that your cash position is sound.

If the loan is given to a small corporation, the lender may require your personal guarantee. In other words, you agree that if the company cannot repay the loan, you will. In fact, most banks require personal guarantees for loans made to small corporations.

¹S & B Corporation has prepared a book entitled "Sources of Venture Capital" — which lists venture capital firms in Canada. Call 945-2057 for more information.

Conditional Sales Purchases

In many cases, manufacturers of new equipment will assist in financing the purchase of their equipment through the use of conditional sales purchases. The manufacturer will take the purchaser's note after a down payment of one-quarter to one-third of the purchase price. The ownership of the property under such an arrangement is retained by the seller until the buyer has made all the required monthly or quarterly payments over the term of the contract.

Leasing

More and more businesses are using leasing as a means to finance the use of equipment without large capital expenditures. A company can acquire the use of equipment by merely committing itself to pay rentals without making a substantial cash payment. The lease is usually written on the total customer selling price and is drawn for a period of three to five years. The total amount to be paid is computed by adding finance charges to the total customer selling price.

Sale-leaseback arrangements have also become increasingly popular in recent years. By this method of financing, a company sells an asset to an insurance company or other institution and then immediately leases it back. Here again, the lessee obtains working capital and rental payments can, in most cases, be charged as an expense for tax purposes. The sale-leaseback arrangement makes it possible for the seller to borrow more money than he might have been able to if the business owner held encumbered property. Leases are generally medium term and the good credit standing of the lessee is important. For new businesses, leasing can be advantageous in that equity capital can remain intact for operating expenses.

Financing Working Capital

Obtaining sufficient working capital is frequently cited as one of the more difficult problems facing small business. Retail stores can be especially hard pressed in this regard. However, there are a number of methods by which operating money can be obtained through debt financing.

Line of Credit (Demand Loans)

A line of credit is provided by banks to support working capital required by the business. The bank will negotiate to lend up to a certain amount of money, providing certain terms and conditions are met. The bank can cancel the line at any time it considers necessary (hence the name "demand loan"). However, it will not generally cancel without cause. A line of credit is extremely useful to a business.

The loan will go up and down as the business needs the money and interest is paid only on the amount outstanding. Generally, it is wise to avoid continuous operation at the upper end of the credit line. Bankers appreciate full use of an approved line of credit. They do not welcome either under or over utilization.

Character Loans

Character loans are given to individuals or companies with excellent credit ratings. They are generally unsecured loans made for the short term to be used for general purposes.

Commercial Loans

These are self-liquidating loans made for the short term (30 to 90 days). They are generally used for such things as seasonal financing for inventory purchases.

Accounts Receivable Financing

In accounts receivable financing, lenders make cash advances to borrowers using accounts receivable as security. There are two methods by which this is accomplished. In the first method, the borrower's customers are asked to remit payment directly to the lender. This arrangement is generally not desirable as it could upset the relationship between the borrower and his customers. In the second method, the borrower receives payment from his customers and remits the total payment intact to the lender. The lender will release the borrower's indebtedness and return any excess payments after deducting finance charges.

With accounts receivable financing, the borrower is able to secure a continuous source of operating cash without entering into long-term financing arrangements. The relationship with the finance company can develop into a continual arrangement whereby up to 80% of the assigned accounts can be financed. It is important to recognize, however, that the borrower is still responsible for collecting the accounts receivable.

Factoring

Factors are companies involved in purchasing outright the accounts receivable of their clients. It usually means a continuous agreement whereby the factor is responsible for granting credit to the business customers, performing the accounts receivable bookkeeping and collecting the accounts. In other words, the factor assumes all risks in regard to granting credit and collections. Generally cash is made available to the client on the collection date of the goods sold.

To do business with a factor, the volume of business must be sizeable (about \$250,000); the prospective client should sell on normal credit terms and the majority of its customers should have good credit ratings.

Factoring companies generally service manufacturers and wholesalers engaged in the production and selling of items for which there is a continuing or repeat business. See your Yellow Pages under "Factors".

Inventory Financing

For some established firms, inventory will be financed by banks or commercial finance companies up to 75% of the value for both raw materials, work in progress and finished goods. Section 88 of the Bank Act enables chartered banks operating under the Bank Act to lend against security consisting of products of the mine, forest or stream. However, in most cases of inventory financing, good rapport has been established over a period of time between the lender and the borrower. For new business, inventory financing can be difficult to obtain.

FEDERAL AND PROVINCIAL PROGRAMS

The Federal and the Provincial Governments offer a number of assistance programs, if the business can qualify. Such assistance may be in the form of:

- human resource development
- loan guarantees

Detailed information about federal programs can be obtained by calling the Business Services Centre at (Winnipeg) 983-6182.

Information on Provincial programs is available through the Business Resource Centre, 6th Floor - 155 Carlton Street, Winnipeg, MB R3C 3H8 Telephone: 945-7738 or Toll Free within Manitoba 1-800-282-8069. The Western Regional Office is located in Brandon. Telephone: 726-6250.

APPROACHING A LENDER

Generally speaking, starting a new business is a risky endeavor and no one is more aware of this than a banker. If starting a new business is a risk, then financing a business facing current financial problems is even riskier. The lender must be convinced that the proposition is sound and profitable and that you have the ability to make a success of it.

Plan your requirements well ahead. It is important to approach your banker early. A lender does not want to be approached at the last minute with a crisis situation such as a payroll you are unable to meet. He/she often needs time to assess the proposal. Also, it is often possible that the person dealing with you cannot approve the loan on his/her own.

Building a good working relationship with a bank is not always easy. Some people cannot understand why a bank will refuse to lend them money for business purposes or attaches what seems to be restrictive conditions. If the bank does not lend you money, it is probably because they recognize risks in your scheme in which they are not prepared to participate. Thus, they could be indirectly looking after your better interests. By granting credit they actually could be doing you a disservice.

In choosing a bank, ask business acquaintances or local merchants about the bank they use. It is important to deal with a banker who will be interested in your business and will sympathize with your aspirations. It is often easier to build a relationship with a bank that is somewhat familiar with your type of business. Often local bankers develop a substantial amount of information about the kinds of businesses in their area which helps them to understand and evaluate your requirements and financial status more quickly.

It is advisable to approach more than one lender but do not shop for a bank too extensively. It is time-consuming and most lenders work on the same principles.

If you are unfamiliar with a lender's requirements regarding business loans, it is best to set up an initial appointment to discuss the lender's policies without going into the specifics of your proposal. During this interview discuss such questions as: Is collateral required? If it is, how much and what type? Does the bank have limitations on the types of businesses to which it will grant loans? What are the repayment terms? What reports or supporting information do you have to make? Will the bank give a line of credit?

Put your proposal in writing in a form such as the framework given in the chapter on financial planning in this handbook. Make sure that adequate financial data is included so the lender can assess your application on the basis of full information.

There is no need to approach a banker with trepidation. He/she is there to serve you. Be confident in your approach and be prepared to negotiate terms. It is best to set up a firm appointment first, so that you will get an uninterrupted hearing.

If the lender does turn down your application, it is important that you understand the reasons why. It is possible that with some adjustments to your proposal, it could become acceptable.

Get to know your banker and be able to confide in him/her. Acquaint the banker with your business and prove that you are a competent and progressive manager. Some loans officers are unable to recognize business potential and can often block legitimate proposals. If the bank assigns your account to someone who is not interested in learning about your business, ask for another person with whom you can work on a personal basis.

Earn your banker's respect by showing good faith. Build a reputation for integrity by conducting your banking affairs in a logical manner. Observe the banker's policies as this will assist in your relationship. Keep the banker informed on all developments of your business. When a problem occurs, often reasonable solutions can be found if the business manager puts forward an honest front with a plan to tackle it. Stalling and issuing N.S.F. cheques, etc. will doom the business.

There are other methods to building good relationships with your banker. Provide financial data regularly to him/her. Provide copies of profit and loss statements, balance sheets, and budgets. Supplying information on your firm's finances helps to build your reputation for integrity. Invite the banker to visit your place of business and explain your operating procedures and future plans.

APPENDIX A**BASIC ACCOUNTING RECORDS**

The type of accounting records needed depends on the size and scope of the business. For any business except the smallest of enterprises, the services of a qualified accountant are usually required, but the following form the basis of any accounting system:

1 Cash Receipts Journal

A book that details all cash received and deposited, the date received, from whom received and the relative classification of the amounts received:

- Cash sale
- Bank deposit
- Received on account & from a customer
- Other receipts

2 Cash Disbursements Journal

A book that details all cash disbursed and cheques issued, date disbursed, and to whom disbursed. Each amount disbursed is classified:

- Various expenses
- Loan payments
- Fixed asset purchases
- Payment of accounts payable
- Other disbursements

3 Payroll Journal

This book contains a sheet for every employee, that lists:

- Name
- Address
- Social Insurance Number
- Rate of Pay
- Date Paid
- Gross Pay
- Deductions for C.P.P., U.I.C., Income Tax, etc.
- Net Pay
- Number of Payroll Cheque

The Payroll Journal also contains a summary of total payroll and total deductions for each pay period.

4 Accounts Receivable Ledger

This book contains the individual account of each customer who has purchased goods on credit. Each customer has a ledger sheet that details:

- Name
- Address
- Phone number
- Credit information
- Date of sale
- Invoice number
- Date of payment
- Receipt number
- Balance owing

Periodically the individual balances are added up (usually once a month) and the total reconciled to the Accounts Receivable balance in the General Ledger.

5 Accounts Payable Ledger

This book records the individual account of every supplier to whom money is owed. The information and procedures are identical to the Accounts Receivable Ledger.

6 Sales Journal

To record sales both cash and on account.

7 Purchases Journal

To record purchases both cash and on account.

8 General Ledger

This book is the final point of the accounting system. The various amounts from the above 7 books are clarified and totalled. The financial statements are prepared from this book.

BASIC FINANCIAL STATEMENTS

1 Balance Sheet

The balance sheet is basically a statement showing what you own and what you owe. It consists of two sections: namely, the assets of the company, and the liabilities and owner's equity. These two parts form an equation which must hold in any balance sheet. That is:

$$\text{ASSETS} = \text{LIABILITIES} + \text{OWNER'S EQUITY (OR NET WORTH)}$$

In other words, what you put into the business yourself, plus what you borrow must equal your assets (e.g. cash, machinery, buildings, supplies, etc.). The distinction between liabilities and owner's equity is made in order to show you how many dollars you have put in to purchase assets and how much you have borrowed to purchase assets.

The balance sheet shows you the condition of the firm for one point in time. This statement is rarely the same for any two points in time because the items on the balance sheet are constantly changing. For example, you are always buying new assets, selling others, paying off debts (liabilities) etc. When you compare two balance sheets at different points in time, you can see what happened in that period with regard to your asset, liability and equity positions. A typical balance sheet along with definitions is included in this section.

Balance Sheet Terms, Definitions

- 1) **ASSETS:** Anything which the business owns (recorded at cost). These commonly include cash, accounts receivable, inventories, land, buildings and other assets.
- 2) **CURRENT ASSETS:** Cash and other assets that will be converted into cash during the normal operating cycle of the business, generally a year.
- 3) **CASH:** Money on deposit in the bank and petty cash.
- 4) **ACCOUNTS RECEIVABLE:** The amount due from customers for merchandise or services purchased but not yet paid.
- 5) **INVENTORY:** The amount of finished product, work in process and other raw material and supplies on hand.
- 6) **FIXED ASSETS:** Items secured for long-term use in business. They are usually not for resale, and are recorded at cost less depreciation.
- 7) **DEPRECIATION:** Allowance made for loss in value of certain Fixed Assets due to wear and tear, obsolescence or other factors.
- 8) **TOTAL ASSETS:** Current, fixed assets, and other assets totalled.
- 9) **LIABILITIES:** Claims of creditors, i.e. the debts owed.
- 10) **CURRENT LIABILITIES:** The money owed is due within one year.

11) **PAYMENTS DUE ON LONG-TERM LOANS:** Represents money owed due within one year.

12) **ACCOUNTS PAYABLE:** The amount owed to suppliers and other business creditors for materials, merchandise, insurance, etc.

13) **LONG-TERM LIABILITIES:** Those debts or other obligations that are not due within one year. For example, long-term mortgages on property owned, long-term loans, and long-term purchase contracts.

14) **SHAREHOLDER'S LOAN:** Loan made by owner to the business.

15) **TOTAL LIABILITIES:** Total of current and fixed liabilities.

16) **OWNER'S EQUITY:** Owner's investment in the business.

17) **RETAINED EARNINGS:** That part of profits left in the business.

18) **TOTAL LIABILITIES AND OWNER'S EQUITY:** Liabilities and owner's equity are totalled, and must equal Total Assets, i.e.

$$\text{Total Assets} = \text{Total Liabilities} + \text{Owner's Equity}$$

A blank Balance sheet has been provided for your use (See Worksheet 2, page 28).

TYPICAL BALANCE SHEET

DATE _____

ASSETS**CURRENT ASSETS**

Petty Cash		\$ 200.00
Cash in Bank		5,000.00
Accounts Receivable	\$ 10,000.00	
Less: Allowance for Loss	<u>1,000.00</u>	9,000.00
Inventory		<u>8,000.00</u>
Total Current Assets		\$ 22,200.00

FIXED ASSETS

	Cost	Allowance for Depreciation	Book Value	
Land	\$ 5,000.00		\$ 5,000.00	
Buildings	25,000.00	2,500.00	22,500.00	
Equipment	10,000.00	2,000.00	8,000.00	
Cars & Trucks	<u>9,000.00</u>	<u>2,700.00</u>	<u>6,300.00</u>	
Totals	\$ 49,000.00	\$ 7,200.00	\$ 41,800.00	<u>41,800.00</u>
Total Assets				\$ 64,000.00

LIABILITIES**CURRENT LIABILITIES**

Accounts Payable	\$ 2,000.00
Bank Loans	4,000.00
Payments due 12 months (long term loans)	<u>4,800.00</u>
Total Current Liabilities	\$ 10,800.00

LONG TERM LOANS20,000.00**SHAREHOLDER'S LOAN**20,000.00**Total Liabilities****\$ 50,800.00****OWNER'S EQUITY**

INVESTMENT	\$ 10,000.00
Retained Earnings	<u>3,200.00</u>
Total Owner's Equity	

13,200.00**TOTAL LIABILITIES AND
OWNER'S EQUITY****\$ 64,000.00**

BASIC FINANCIAL STATEMENTS

2 Income Statement

The income statement presents a picture of the income that is generated by a business for a stated period. This statement shows you what your sales were (or what they might be if you are projecting), what the goods sold cost you and what expenses are incurred. After the cost of goods and all expenses are deducted from the sales, you arrive at either net income or a loss for the period. You can then compare this with different periods to see the changes that have taken place in sales, cost of goods sold, and expenses.

The income statement should never be confused with the cash flow statement. Rarely does your income from a given period equal the cash that is coming in. Your sales on the income statement takes into account credit sales as well as cash sales. Credit sales do not increase your cash position until they are actually collected in cash. It is therefore possible to have a healthy profit on the income statement and yet be short of cash to meet your expenses on the cash flow statement. Depreciation is deducted from revenue on the income statement yet it is not a cash expense. Therefore, you should use both income statements and cash flow statements as well as the balance sheet to assess the relative profitability of the firm, the financial condition of the firm and the overall condition of the firm at any particular time. A typical income statement along with definitions is included in this section.

Income Statement, Definitions

- 1) GROSS SALES: This represents the gross or total dollar sales.
- 2) NET SALES: Sometimes cash discounts are deducted from gross sales thus the term 'Net' sales.
- 3) COST OF GOODS SOLD:
 - a) Beginning inventory (at start of period): The inventory on hand for sale at the beginning of the period.
 - b) Net purchases: Net purchases made during the period. (Takes into account goods returned to supplier.)
 - c) Total Cost of Goods Available for Sale: The inventory on hand at the beginning of the period plus purchases (a & b).

d) Less Ending Inventory (at end of period): This represents the inventory at the end of the period or goods in stock.

e) Cost of Goods Sold: Above, (c & d).

4) GROSS MARGIN: Net sales less cost of goods sold.

5) OPERATING EXPENSES: The selling and administrative costs incurred. These include items such as owner's salary, employees' wages, rent, utilities, supplies, repairs and maintenance, advertising, delivery expense and other expense items incurred.

6) NET OPERATING INCOME: Gross margin less operating expenses.

7) ESTIMATED INCOME TAX: Tax owing on net income generated.

8) NET INCOME AFTER INCOME TAX: The net income after all expenses and taxes.

A blank Income Statement has been provided for your use (See Worksheet 3, page 29).

NOTE: Inventories Include: Raw Materials, Work in Process, Finished Goods.

TYPICAL INCOME STATEMENT FOR A SMALL COMPANY

Gross Sales		\$98,500
Cash Discounts		<u>2,000</u>
Net Sales		\$96,500
Less Cost of goods sold:		
Beginning inventory	\$10,000	
Plus: net purchases	<u>25,000</u>	
Total	\$35,000	
Less: Ending inventory	<u>8,000</u>	
Cost of goods sold	\$27,000	<u>27,000</u>
Gross Income		\$69,500
Less Operating expenses:		
Bank charges and interest	\$1,200	
Owner's salary	15,000	
Employees' wages	30,000	
Rent	5,000	
Utilities (heat, light, water, power)	5,000	
Supplies	1,000	
Repairs and maintenance	500	
Advertising	2,000	
Delivery expense	500	
Taxes and licences	500	
Depreciation	3,600	
Bad debts	200	
Miscellaneous expenses	<u>1,000</u>	
Total operating expenses	\$65,500	<u>65,500</u>
Net operating income		\$4,000
Income tax (estimated)		<u>800</u>
Net income after income taxes		<u>\$ 3,200</u>

APPENDIX B

SOURCES OF BUSINESS FINANCE

with particular attention to the needs of small business.

Where you should go	What others have found and What you should expect	What they will lend you money for
Banks	• They assess management ability and viability of business • You will have to have some of your own money invested • Money usually has to be paid back after a short term • Slightly higher interest rate than that for big business • They will want security — either mortgage on property or equipment lien, or personal guarantees	They make loans for • equipment • real estate • operating capital
Leasing companies (You can find them in the phone book yellow pages under the heading: Leasing Service. See also Loans)	• Good for financing buildings and equipment for varying number of years • At the end of the time the business may be able to own the building or equipment • May be able to finance, rent or purchase and not have to put out too much at one time • Possible tax advantages	Main purpose is to finance by leasing buildings or equipment
Credit Unions	• You must be a member of the Credit Union to get a loan • Short and long-term loans, flexible terms • Usually require some of your own money invested in the company	They provide money for • real estate • equipment • operating capital

Where you should go	What others have found and What you should expect	Eligibility
Federal Business Development Bank (FBDB) Brandon 940 Princess Street Brandon, Manitoba R7A 5Y6 Tel. (204) 726-7570 Winnipeg 11th Floor, 155 Carlton Street Winnipeg, Manitoba R3C 3R6 Tel. (204) 983-7900	• Covers both established as well as new businesses • Usually lend to businesses which can't get financing from chartered banks • Will require either a mortgage or pledge on equipment • May take an equity position • Will package business proposals for a fee • Provide "matchmaking" (investors and investment opportunities)	They lend money for • real estate • equipment • operating capital • change of ownership
Department of Industry, Science & Technology 8th Floor, 330 Portage Avenue Winnipeg, MB R3C 0C4 Tel. (204) 983-6182	• Program for Export Market Development • Promotes international trade & industry development • Expands the scientific, technological, managerial and production base	• Support sector competitiveness initiative and provide business information and development services.
Federal Business Development Bank Business Information Tel. (204) 983-7900	• Small Business Improvement Loan Program • Interest rate set at 1% over prime lending (fluctuates)	• Small business enterprises in manufacturing and processing
Western Diversification Program Ste. 712, The Cargill Building 240 Graham Avenue Winnipeg, MB R3C 2L4 Tel. (204) 983-4472	• Promotes new product development/commercialization • Plant establishment/expansion • New market development/expansion	• New technologies to enhance productivity of industry and offset imports from outside Canada.
Manitoba Industry, Trade & Tourism Business Resource Centre 6th Floor, 155 Carlton Street Winnipeg, MB R3C 3H8 Tel. (204) 945-7738 Toll Free 1-800-282-8069 (within Manitoba)	• Provides information, training and development and counselling services to new and existing businesses • Provides financial and other incentives for manufacturing, technology and tourism development • Trade Assistance Programs • Tourism Market Development • Business Start Program: A matching loan guarantee program to promote new business start-ups by providing access to funding up to \$10,000, as well as education and counselling	• Please contact appropriate program area

Where you should go

Other places to look for financing are:

- Venture capital companies
 - Factoring companies
 - Equipment suppliers
 - Commercial finance companies
 - Life insurance companies
-

APPENDIX C

USEFUL BUSINESS RATIOS FOR SMALL BUSINESSES

One method of financial analysis commonly used is ratio analysis. A variety of ratios can be calculated to help monitor the financial status of the business. As well, by comparing your ratios to industry averages you can get a better idea of how you are faring relative to others in your particular business. Careful ratio analysis will help pinpoint problem areas.

Industry averages for the five ratios explained below, as well as for a number of others such as gross margin, profits on sales, sales to inventory, are published regularly by Dun and Bradstreet and other services. These publications are available for perusal at the Business Resource Centre in Winnipeg and the Western Regional Office in Brandon.

1 Current Ratio

The current ratio measures the liquid assets available to meet all debts falling due within one year's time. The higher the current ratio, the greater the ability of the firm to pay its bills.

$$\frac{\text{Current Assets}}{\text{Current Liabilities}} = \text{Current Ratio}$$

For instance, if you had a current ratio of 1.5, this would mean your debts could be paid one and a half times by current assets.

2 Quick Ratio

The quick ratio (or the quick asset ratio) is similar to the current ratio in that all current assets are taken into account less inventories.

$$\frac{\text{Current Assets} - \text{Inventories}}{\text{Current Liabilities}} = \text{Quick Ratio}$$

This ratio can be interpreted in the same way as the current ratio. The only difference lies in the fact that inventories are excluded. In other words, inventory is probably less liquid than other current assets, therefore the quick ratio should provide a better picture as to a firm's ability to meet its short-term debts than the current ratio would.

3 Average Collection Period Ratio

The average collection period ratio shows how long the money in a business is tied up in credit sales.

$$\frac{\text{Accounts and notes receivable} \times \text{days in year}}{\text{Annual credit sales}} = \text{days}$$

If, for example the ratio came out to 60 days, and the terms are that the final due date is 30 days, the typical receivable is being collected 30 days after the due date. Since a sizeable portion of the receivables are being paid after the due date, the credit policy of the company should be investigated.

4 Inventory Turnover Ratio

The inventory turnover ratio gives an indication of the efficiency of the inventory management of the company. Care must be exercised in interpreting this ratio, since a high ratio may indicate either a high level of efficiency or too low a level of inventory (i.e. frequent stockouts). A low ratio indicates slow-moving inventory which may result in obsolescence.

$$\frac{\text{Cost of Goods Sold}}{\text{Average Inventory}} = \text{Inventory Turnover Ratio}$$

$$\text{Average Inventory} = \frac{\text{Beginning Inventory} + \text{Ending Inventory}}{2}$$

If the turnover ratio turned out to be 2, this would mean that the company sells the total stock of goods twice in one period. Depending on the industry average, a comparison will show whether the ratio is or is not in line.

5 Turnover of Working Capital Ratio

The turnover of working capital ratio measures how actively working capital in a business is functioning in terms of sales. Working capital is assets that can be converted into operating funds within a year (or working capital = current assets - current liabilities).

$$\frac{\text{Net Assets}}{\text{Working Capital}} = \text{Turnover of Working Capital}$$

A low ratio usually means that working capital is not being used efficiently, while a high ratio suggests vulnerability to creditors. Comparison to industry average should provide insight as to what the ratio should be.

IN CLOSING

This, and other Business Plan formats, with examples and explanations, has been published by the Business Resource Centre to help and encourage Manitobans who wish to embark on business ventures in the manufacturing, retail, service and construction fields. If you would like to discuss your Business Plan or have problems and questions related to its preparation, feel free to call the Centre and arrange to meet with one of the counsellors.

Manitoba Industry, Trade and Tourism
Business Resource Centre
6th Floor, 155 Carlton Street
Winnipeg, Manitoba, CANADA
R3C 3H8

Telephone: (204) 945-7738
Toll Free in Manitoba: 1-800-282-8069

Manitoba Industry, Trade and Tourism
Western Regional Office
P.O. Box 1300
231-10th Street
Brandon, Manitoba, CANADA
R7A 6N1

Telephone: (204) 726-6250
Fax: (204) 726-6403

WORKSHEET 1

TYPICAL STATEMENT OF PERSONAL NET WORTH

DATE: _____

NAME: _____

ADDRESS: _____

GENERAL INFORMATION

Phone: Home _____ Business _____

Present Employer _____ Position _____ How Long With This Employer _____

Occupied _____

Previous Employer _____ How Long _____

Monthly Rental _____

Landlord _____ Address _____

Salary, Wages or Commission Per Annum \$ _____ Other Income Per Annum \$ _____ Source _____

Guarantees on Debts Of Others: Name _____ Amount _____

Accountant _____ Address _____

Lawyer _____ Address _____

ASSETS

Bank Accounts _____

Stocks At Cost (Market Value _____) _____

Bonds At Cost (Market Value _____) _____

Life Insurance (Cash Surrender Value) _____

Beneficiary _____

Automobile — Year _____ Make _____

Home — Mortgage Registered with _____

— Building Size _____ Lot Size _____

Other Assets _____

Total _____

LIABILITIES

Bank Loan _____

Charge Accounts _____

Policy Loans on Life Insurance _____

Other Loans _____

Installment Purchases _____

Mortgages: Int. Rate _____ Term _____ Payments _____

Taxes _____

Other Liabilities _____

Sub Total _____

NET WORTH (Total Assets less Total Liabilities) _____

WORKSHEET 2

TYPICAL BALANCE SHEET

DATE _____

ASSETS**CURRENT ASSETS**

Petty Cash		.....
Cash in Bank		.....
Accounts Receivable	.....	
Less: Allowance for Loss	.....	
		
Inventory		.....
Total Current Assets		.....

	Cost	Allowance for Depreciation	Book Value
FIXED ASSETS			
Land			
Buildings			
Equipment			
Cars & Trucks			
Totals			
Total Assets			

LIABILITIES**CURRENT LIABILITIES**

Accounts Payable	.....
Bank Loans	.....
Payments due 12 months (long term loans)	.....
Total Current Liabilities	

LONG TERM LOANS**SHAREHOLDER'S LOAN**

Total Liabilities	
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OWNER'S EQUITY

INVESTMENT	
Retained Earnings	
Total Owner's Equity	

**TOTAL LIABILITIES AND
OWNER'S EQUITY**

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WORKSHEET 3

TYPICAL INCOME STATEMENT FOR A SMALL COMPANY

Gross Sales		
Cash Discounts		
Net Sales		.....
Less Cost of goods sold:		
Beginning inventory	.....	
Plus: net purchases	.....	
Total	.....	
Less: Ending inventory	.....	
Cost of goods sold	.....	.....
Gross Income		.....
Less Operating expenses:		
Bank charges and interest	.....	
Owner's salary	.....	
Employees' wages	.....	
Rent	.....	
Utilities (heat, light, water, power)	.....	
Supplies	.....	
Repairs and maintenance	.....	
Advertising	.....	
Delivery expense	.....	
Taxes and licences	.....	
Depreciation	.....	
Bad debts	.....	
Miscellaneous expenses	.....	
Total operating expenses	.....	.....
Net operating income		.....
Income tax (estimated)		.....
Net income after income taxes		.....